



Federal Accounting Standards Advisory Board

October 12, 2017

Memorandum

To: Members of the Board

Monica R. Valentine

From: Monica R. Valentine, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Leases Statement —Tab A¹**

MEMBER ACTION REQUESTED:

- Provide staff with feedback regarding the pre-ballot draft Leases statement by **October 20, 2017**.

MEETING OBJECTIVE

The objective is to obtain feedback on the pre-ballot draft Statement, *Leases*. As a reminder, the pre-ballot offers members an opportunity for *minor edits* but not to make substantive changes.

BRIEFING MATERIAL

The briefing material includes this memorandum and the following attachments and appendices:

Attachment 1: Pre-ballot Draft Leases Statement - **Marked**

Attachment 2: Pre-ballot Draft Leases Statement - **Clean**

Appendix A: History of Board Lease Discussions

BACKGROUND

At the August meeting the Board reviewed a draft *Leases* Statement and gave staff feedback on several technical issues. Staff discussed the following issues with the Board:

- Definition of a lease

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

- Service contracts
- Lease-term determination
- Effective date of the standards
- Possibility of re-exposure
- Other revisions to the standards

The Board agreed on the following:

- The scope of the lease definition should be narrowed to “*a contract or agreement that conveys the right to control the use of another entity’s identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.*”
- The definition of service contracts should be included in the leases standards.
- Language should be added to clarify the “noncancelable period.”
- Both the lessee and the lessor’s options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.
- When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold. In contrast, when the lessee or lessor is assessing the other party’s options to extend or terminate the contract or agreement, the level of probability is at a higher threshold, like reasonably certain. This requires significant evidence of the other party’s future action.
- The effective date of the *Leases* Statement should be changed to reporting periods beginning after September 30, 2020 (fiscal year 2021).
- The Board agreed to several editorial changes.
- Re-exposure of the leases standards is not necessary.
- The Board asked staff to reach out to the task force members to see if the new wording is clear and if the Board had been responsive to their concerns. The Board also wanted to get the task force’s thoughts on the revisions to see if any of the changes cause any additional burden.

After the August Board meeting staff reached out to the task force to specifically ask for their thoughts on the revisions and to see if they believe any of the changes inadvertently caused additional preparer burden compared to the ED. Staff also asked the task force to identify any substantive revisions needed. Staff received replies from eight task force members, including GSA and DoD. Many of the recommendations can be addressed with implementation guidance. The pre-ballot draft includes those task force suggested revisions that staff deemed appropriate.

OTHER REVISIONS

Staff also made other revisions to the draft Leases standard to improve the clarity of the standard. The revisions are based on

- suggestions from ED respondents,
- revisions adapted from the GASB final lease standard, and
- staff suggested revisions.

NEXT STEPS

If all unresolved substantive issues have been resolved by the Board, staff will make all revisions agreed to by the Board and present a ballot draft of the final Leases statement to the Board.

MEMBER FEEDBACK

Please contact staff as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact Monica by telephone at 202-512-7362 or by e-mail at ValentineM@fasab.gov with a cc to PayneW@fasab.gov.

QUESTIONS FOR THE BOARD

Question 1: Does the Board agree with the revisions to draft Leases standards?

Question 2: Does the Board agree with the revisions to draft Leases basis for conclusions?



Federal Accounting Standards Advisory Board

LEASES:

AN AMENDMENT OF STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS
(SFFAS) 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT AND
SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards XX

MARKED VERSION

October 12, 2017

PRE-BALLOT DRAFT

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- [“Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”](#)
- [“Mission Statement: Federal Accounting Standards Advisory Board”](#), [exposure drafts](#), [Statements of Federal Financial Accounting Standards and Concepts](#), [FASAB newsletters](#), and other items of interest are posted on FASAB’s website at: www.fasab.gov .

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SUMMARY

This Statement revises the ~~accounting and~~ financial reporting standards for federal lease accounting ~~standards~~. ~~The Statement~~^{It} provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes ~~s~~ appropriate disclosures.

~~This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definitions of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definitions of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases. This Statement requires that federal lessees recognize a lease liability and a leased asset at the beginning of the lease, unless it meets any of the scope exclusions, is an intragovernmental lease, or a short term lease. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions, is an intragovernmental lease, a short term lease.~~

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E)² (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, an entity should assess whether the federal entity has both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement.
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement.
4. This definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 72). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.
5. This Statement does not apply to:
 - a. ~~Leases~~ leases of assets under construction ~~- or~~
 - b. ~~Leases~~ leases (licenses) of internal use software (~~See~~ SFFAS 10, *Accounting for Internal Use Software*, as amended).

¹ Terms defined in the Glossary are shown in **bold-face** the first time they appear.

² ~~See~~ SFFAS 6, *Accounting for Property, Plant, and Equipment*.

DEFINITIONS

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement that conveys the right to control the use of another entity's ~~property, plant, and equipment~~ (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.
7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.
8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined ~~under-in~~ SFFAS 47, *Reporting Entity*.³
9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.
12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.
13. **Initial Direct Lease Costs** – Initial direct ~~lease~~ costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases ~~and that~~ would not have been incurred without entering into the lease.

³ ~~See~~ SFFAS 47, *Reporting Entity*, par. 38-42.

- ~~14. **Lease Incentives**—Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.~~
- ~~15. **Lease Concessions**—Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.~~
- ~~16. **Leasehold Improvements**—Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.~~
- ~~17. **Lessor Improvements**—Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.~~

LEASE TERM

- ~~14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease, if any. The noncancelable period is the shorter of~~
- ~~a. the period identified in the lease contract or agreement that precedes any option to extend the lease; or~~
 - ~~b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.~~
- ~~18. The lease term is the period during which a lessee has a noncancelable right to use an underlying asset (referred to as the noncancelable period), plus the following periods, if applicable:~~
- ~~a. Those periods specified in the lease contract or agreement that include a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option~~
 - ~~b. Those periods specified in the lease contract or agreement that include a lessee's option to terminate the lease if it is probable, based on all relevant factors, that the lessee will *not* exercise that option~~
 - ~~c. Those periods specified in the lease contract or agreement that include a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option~~

~~d. Those periods specified in the lease contract or agreement that include a lessor's option to terminate the lease if it is probable, based on all relevant factors, that the lessor will not exercise that option.~~

15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:

a. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is **probable**, based on all relevant factors, that the lessee will exercise that option

b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option.

c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option

d. Those periods specified in the lease contract or agreement that follows a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option.

~~19. The period during which a lessee has a noncancelable right is the shorter of~~

~~a. the initial lease period, before considering option periods to extend the lease; or~~

~~the period of the lease preceding an option for the lessee to terminate the lease if it is probable, based on all relevant factors, that the lessee will exercise that option to terminate; or~~

~~b. a. the period of the lease preceding a point at which either the lessee or the lessor have an option to terminate the lease, regardless of the probability of termination.~~

16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

~~20. In determining the lease term, the following specific provisions should be applied:~~

~~a. Month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate, and therefore either could cancel the lease at any time. These~~

~~holdover periods are cancelable periods and should be excluded from the lease term.⁴~~

~~b. Provisions that allow for termination of a lease due to (a) purchase of the underlying asset, (b) payment of all sums due, or (c) default on payments are not considered options to terminate.~~

~~c.a. A fiscal funding or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.~~

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:

a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option

b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option.

c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option

d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option.

18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; subsequent option periods would not be evaluated.

19. In determining the lease term for the lessee and lessor, the following specific provisions should be applied:

a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend, are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to

⁴ ~~SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.~~

terminate. Therefore either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁵

b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.

c. A fiscal funding or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

21.20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraphs 15-18¹⁴, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

- a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates
- b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
- c. The history of exercising options to extend or terminate
- d. The extent to which the asset underlying the lease is mission critical to the federal entity

22.21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:~~Lessors and lessees should reassess the lease term only if any of the following occur:~~

- a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17
- b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17
- c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

⁵ SFFAS 1, Accounting for Selected Assets and Liabilities, applies to any related accounts payable or accounts receivable amounts.

- ~~a. The lessor or lessee elects to exercise an option even though it was previously determined that it was probable that the lessee would not exercise that option~~
- ~~b. The lessor or lessee does not elect to exercise an option even though it was previously determined that it was probable that the lessee would exercise that option~~
- ~~c. a. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.~~

SHORT-TERM LEASES

~~23-22.~~ A short-term lease is a lease with a lease term (as defined in paragraphs ~~14~~ 21) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

~~24-23.~~ A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate, or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

~~25-24.~~ A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate, or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

~~26-25.~~ A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement, and (b) does not contain options to terminate (~~see~~ par. 14 - ~~1945~~), but that may contain a fiscal funding or cancellation clause that is not probable of being exercised (~~see~~ par. ~~19.c46.d~~), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁶

INTRAGOVERNMENTAL LEASES

⁶ See SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

- ~~27-26.~~ An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined ~~under in~~ SFFAS 47, ~~Reporting Entity~~. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs ~~2724 – 3836 below~~.
- ~~28-27.~~ A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the lease contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
- ~~29-28.~~ A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the lease contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
- ~~29.~~ Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.
30. Variable rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (~~for example,~~ tied to a specific economic indicator where the specific amount of the change is not known).
31. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase as provided in the lease.
32. **Lease incentives** should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.
33. **Lease concessions** should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.

34. **Leasehold improvements** that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the ~~owner~~lessee) of the leasehold improvement, but no longer than the expected lease term.
35. **Lessor improvements** are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for ~~property, plant, and equipment~~PP&E.⁷
36. **Initial direct lease costs** incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

DISCLOSURES

37. Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including
- a. existence of intragovernmental leases and annual expense,
 - b. general lease terms with specific intragovernmental requirements (which may be grouped for purposes of disclosure), and
 - c. annual lease expense by major leased asset category.
38. Lessors should disclose the following regarding intragovernmental leases:
- a. Future lease payments that are to be received for each of the five succeeding fiscal years for lease arrangements over the lease term
 - b. A broad summary of significant leases (which may be grouped for purposes of disclosure), including a breakdown of the number of leases with federally-owned assets and privately-owned assets

LESSEE RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN ~~INTRAGOVERNMENTAL LEASES~~, SHORT-TERM LEASES, ~~AND~~ CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, ~~AND~~ INTRAGOVERNMENTAL LEASES

39. At the commencement of the lease term, a lessee should recognize a lease liability and a ~~property, plant, and equipment (PP&E)~~ right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in, paragraphs ~~2249~~ - ~~2424~~ (short-term leases), paragraph ~~2522~~ (contracts or agreements that transfer ownership), and paragraph ~~2623~~ - ~~3836~~ (intragovernmental leases)

⁷ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, Accounting for Property, Plant, and Equipment, par. 37.

LEASE LIABILITY

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable payments that are fixed in-substance as described in ~~paragraph-~~ 4139
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
 - e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
 - g. Any lease incentives (~~as discussed in~~ par 6967 and 7068) receivable from the lessor
 - h. Any other payments that are probable of being required based on an assessment of all relevant factors
41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense ~~in the statement of net cost~~ in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**⁸ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.
43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

⁸ A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes⁹ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability since the previous measurement:
- a. There is a change in the lease term
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable, or vice versa.
 - c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. ~~4541~~).
 - e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**.
 - f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability ~~under in~~ paragraph ~~4038~~. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.
45. If a lease liability is remeasured for any of the changes in paragraph ~~4442~~, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.
46. The lessee also should update the discount rate as part of the remeasurement if one or both of the changes in ~~par-paragraph 44.a42.a.~~ or ~~44.c42.c~~ have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability .:
47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.
48. If the discount rate is required to be updated based on the provisions in ~~par-paragraph 4644~~, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

⁹ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs ~~79X–85X~~ for lease modifications and terminations.

49. A lessee should initially measure the lease asset as the sum of the following:

- a. The amount of the initial measurement of the lease liability (~~see~~ par. 4038)
- b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (~~as discussed in~~ par. 6967. and 7068)
- c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in ~~par. paragraph~~ 5149. The amortization of the lease asset should be reported as amortization expense.

51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

52. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on ~~par. paragraph 4442–4846~~. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

53. Leased assets classified as ~~property, plant, and equipment PP&E~~ are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The change in the manner or duration of use of the underlying asset is an indicator that the right of use asset may be impaired (~~described in SFFAS 44~~ par. 12 ~~of SFFAS 44~~). If the underlying asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.¹⁰

DISCLOSURE REQUIREMENTS FOR LESSEES

54. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

- a. A general description of its leasing arrangements, including:
 - i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - ii. the existence, terms, and conditions of residual value guarantees provided by the lessee
- b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets
- c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability

¹⁰ See SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18 – 25.

- d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
- e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

LESSOR RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN SHORT-TERM LEASES, ~~AND~~ CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP ~~AND INTRAGOVERNMENTAL LEASES~~

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph ~~2249~~ - ~~2424~~ (short-term leases) paragraph ~~2522~~ (contracts or agreements that transfer ownership), and paragraphs ~~2623~~ - ~~3836~~ (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable lease payments that are fixed in-substance as described in paragraph ~~5755~~
 - d. Residual value guarantees that are fixed payments in substance (~~as described in par. 5756~~).
 - e. Any lease incentives (~~as discussed in par. 6967 and 7068~~) payable to the lessee.
57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.
58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is

required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.
60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes¹¹, and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable since the previous measurement:
 - a. There is a change in the lease term.
 - b. There is a change in the interest rate the lessor charges the lessee.
 - c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable under-in paragraph 5654. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.
62. If a lease receivable is remeasured for either of the changes in paragraph 619, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
63. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes in paragraph 61.a59.a. or 61.b59.b have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable

DEFERRED REVENUE

64. A lessor initially should measure the deferred revenue to include the following as follows:

¹¹ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 79X-85X for lease modifications and terminations.

- a. The amount of the initial measurement of the lease receivable (see par. [5654](#))
 - b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (as discussed in par. [6966](#) and [7067](#)) paid to, or on behalf of, the lessee at or before the commencement of the lease term.
65. A lessor subsequently should recognize [the](#) deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs [6159-6364](#).

UNDERLYING ASSET

66. A lessor should **not** derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

67. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
 - b. The carrying amount of assets on lease, by major classes of assets, and the amount of accumulated depreciation
 - c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases
 - d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties.
68. In addition to the disclosures in paragraph [6765](#), if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

LEASE INCENTIVE [S](#) AND LEASE CONCESSIONS

69. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

70. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (see par. 4930). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 4021–4829) and by lessors consistently with the lessor's lease receivable (par. 5644–6352). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. However leasehold improvements are paid for (financed) by the lessee, therefore leasehold improvements would not be considered a lease incentive or concession received from the lessor.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

70-71. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

71-72. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 7573.

72-73. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 7573.

73-74. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the

contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.

~~74-75.~~ If a contract or agreement does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph ~~7472~~, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.

~~75-76.~~ If multiple components are accounted for as a single lease unit as provided for in paragraph ~~7573~~, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

~~76-77.~~ Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:

- a. The contracts or agreements are negotiated as a package with a single objective.
- b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.

~~77-78.~~ If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs ~~7169–7674~~.

LEASE TERMINATIONS AND MODIFICATIONS

~~78-79.~~ The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, ~~a~~-lengthening or shortening ~~of~~ the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case

the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs ~~1544-19~~, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

~~79-80~~. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

LESSEE TREATMENT OF LEASE TERMINATIONS

~~80-81~~. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability, and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

LESSOR TREATMENT OF LEASE TERMINATIONS

~~81-82~~. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

~~82-83~~. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:

- a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.
- b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

LESSEE TREATMENT OF LEASE MODIFICATIONS

~~83-84~~. Unless a modification is reported as a separate lease as provided in paragraph ~~8384~~, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability

immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

LESSOR TREATMENT OF LEASE MODIFICATIONS

~~84-85.~~ Unless a modification is reported as a separate lease as provided in paragraph ~~8384~~, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

~~85-86.~~ A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

~~86-87.~~ The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

~~87-88.~~ Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction ~~should include a transaction~~ that qualifies as a sale¹² to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

~~88-89.~~ The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions – a sale transaction and a lease transaction – except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

¹² See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

- ~~89.90.~~ A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.
- ~~90.91.~~ A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. ~~5452~~). A buyer-lessor should provide the disclosures required of a lessor (par. ~~6765~~).

LEASE-LEASEBACK TRANSACTIONS

- ~~91.92.~~ In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

AMENDMENTS TO SFFAS 5, *ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT* AND SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

92.93. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43 – 46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

~~[43.] **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

~~[44.] The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote ²⁰: “The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

~~[45.] The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee’s incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee’s incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee’s incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

~~[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote ²¹: OMB Circular No. A-11, “Preparation and Submission of Annual Budget Estimates,” explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, “Guidelines and Discount Rates for Benefit-Cost~~

~~Analysis of Federal Programs,” provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]~~

- | ~~93:94.~~ This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: *Accounting for Property, Plant, and Equipment*

~~[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote⁷: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [footnote⁸: “Operating leases” of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life [footnote⁹: “Estimated economic life of leased property” is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote¹⁰: “Fair value” is the price for which an asset could be bought or sold in an arm’s-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler’s Dictionary for Accountants)] of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.~~

~~[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote²⁴: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).~~

94. This Statement also amends Technical Release (TR) 16, *Implementation Guidance for Internal Use Software*, paragraphs 26, 27, and 29 to delete the “capital and operating lease” references, as follows:

Technical Release 16: *Implementation Guidance for Internal Use Software*

~~[26.] Software License: If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in SFFAS X SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with an upfront cost [footnote⁹: The cost could be charged as a one-time payment or financed over a set period of time.] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.~~

~~[27.] A license agreement may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts [footnote¹⁰: SFFAS X SFFAS 5, paragraph 44.] may be derived from the payment schedule contained in the license agreement. As stated in SFFAS 5, If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.~~

~~[29.] If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS X SFFAS 5 and SFFAS 6, and as discussed in paragraph 26 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform, or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.~~

IMPLEMENTATION

95. This Statement requires that leases unexpired at the beginning of the reporting period in which the standard Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

- a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

- b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

96. The following implementation addresses specific leasing circumstances.

- a. Prospective Implementation - Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.
- b. Lease Term - The lease term should be determined based on the provisions of this Statement (see par. 14 – ~~2148~~). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year ~~20X1~~ and the entity implements this Statement in Year ~~20X7~~ (~~6~~ six years into the lease at the beginning of Year ~~20X7~~), the initial lease term upon implementation would be 14 years.
- c. Short-term leases - A short-term lease would be determined based on the provisions of this Statement (~~see par. 2219 – 2421~~). However, if the remaining lease term of an existing lease meets the definition of a short-term lease (~~has a maximum possible term under the contract or arrangement of 24 months or less, including any options to extend, regardless of their probability of being exercised~~) that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

97. The requirements of this Statement are effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

- A1. This Statement amends the lease accounting standards in *SFFAS 5, ~~Accounting for Liabilities of the Federal Government~~*, and *SFFAS 6, ~~Accounting for Property, Plant, and Equipment~~*. ~~The lease standards in SFFAS 5 and SFFAS 6 which~~ had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.
- A2. ~~The Federal Accounting Standards Advisory Board (FASAB or “the Board”) undertook this project primarily because SFFAS 5 and 6. This project was undertaken primarily because~~
 - a. ~~the current lease accounting standards, Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*, have been criticized as ineffective because they are not comprehensive and~~ do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions, and
 - b. ~~the lease accounting standards in SFFAS 5 and 6~~ are based on Financial Accounting Standards Board (FASB) lease accounting standards which have been amended; ~~in addition existing FASAB standards are not comprehensive and do not provide meaningful information on federal leasing activities.~~
- A3. Lease accounting was first addressed by the FASAB during the development of SFFAS 5 and 6. At that time the Board decided to use the high level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) - Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.
- A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to ~~alleviate questions~~ lessen confusion on ~~when and if whether~~ FASB standards apply to federal entities when ~~the federal standards~~ FASAB's are silent on a topic.

- A5. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing ~~the proposed standards for leases~~this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.
- A6. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. ~~Staff sought The the~~ task force's views and recommendations ~~were sought by staff~~ in developing and describing alternatives to present to the Board ~~during the development of these standards~~. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of ~~this the~~ exposure draft (ED) preceding this Statement.
- A7. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:
- ~~Financial Accounting Standards Board (FASB's) Statement of Financial Accounting Standards (SFAS) 13, Accounting for Leases~~ [~~Superseded superseded~~ by FASB's ~~Accounting Standards Codification (ASC) 840~~, which was subsequently superseded by ASC 842]
 - Governmental Accounting Standards Board's (GASB) ~~Exposure Draft Statement No. 87, Leases, January 25, 2016~~
 - International Accounting Standards Board's ~~(IASB)~~ International Accounting Standard ~~(IAS) 17, Leases, [which was superseded by International Financial Reporting Standard (IFRS) 16.]~~
 - International Public Sector Accounting Standards Board's ~~(IPSASB)~~ International Public Sector Accounting Standard ~~(IPSAS) 13, Leases.~~
- A8. At the inception of the project the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of ~~the proposal~~this Statement. In 2014, FASAB and GASB met ~~jointly~~ to discuss ~~similar~~ issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹³

- A9. This Statement amends the lease accounting standards in SFFAS 5, SFFAS 6, and TR 16. This Statement also establishes distinct standards for intragovernmental leases.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

- A10. FASAB issued the ED, titled *Leases*, on September 26, 2016, with comments requested by January 6, 2017. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of*

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Accountancy, Association of Government Accountants Topics, the CPA Journal, Government Executive, the CPA Letter, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A11. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

- a. House Committee on Oversight and Government Reform
- b. House Committee on Transportation
- c. House Committee on Budget
- d. Senate Committee on Homeland Security and Governmental Affairs
- e. Senate Committee on Budget
- f. Senate Committee on Environment and Public Works

A12. FASAB received 25 responses from preparers, auditors, professional associations, and citizens. Many respondents had concerns with the definition of leases and the scope of the Statement. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A13. The Board extended an invitation to the respondents of the Leases ED to discuss with the Board their comments on the ED and provide further clarification on their responses. In April 2017, five federal entities addressed the Board to further elaborate on their written comments.

A9-A14. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

KEY AREAS OF IMPROVEMENT

A10-A15. This ~~lease proposal~~Statement will improve upon the existing ~~lease accounting standards~~guidance in SFFAS 5 and SFFAS 6 by providing

- a. ~~providing~~ relevant and meaningful financial information needed by federal financial statement users and
- b. ~~providing~~ comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

A16. As previously noted, the lease accounting standards in SFFAS 5 and 6 were based on the FASB lease accounting standards which have been amended. Because FASB standards revised its standards, it was imperative for the Board to revisit the lease accounting standards, and inaction was not an option. The Board closely reviewed the lease proposals of three standard setters to determine what underlying concepts, if any, would be useful for federal lease accounting and financial reporting. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.

A17. The Board strongly considered the costs associated with the lease proposal. Those cost considerations are especially evident with the proposed accounting for short-term and intragovernmental leases. Aside from General Service Administration's (GSA) lease portfolio, the majority of federal entity lease contracts and agreements are intragovernmental leases. This Statement will lessen the preparer's level of effort to account for intragovernmental leases in comparison to the current lease accounting and financial reporting standards.

~~A11.~~A18. The Board believes that in a lease transaction, a lessee receives the right to ~~use~~ an control the use of another entity's PP&E (the underlying asset ~~— (the asset that is~~ subject to the lease, such as a vehicle or building) ~~at the beginning of the lease term for a period of time as specified in the contract or agreement.~~ In exchange, the lessee promises to make payments over time for the right to control the use of that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because ~~their bright-line nature~~they often resulted in ~~very~~ similar leases being accounted for in different ways.

SCOPE

~~A12.~~A19. For purposes of applying this Statement, ~~A-a~~ lease is defined as a contract or agreement that conveys the right to control the use of another entity's ~~property, plant, and equipment (PP&E)~~ (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. Service contracts include maintenance of equipment or real property, advisory services, communications services, transportation services, and research and development unless that contract or agreement also conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange transaction.

~~A13.~~A20. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

~~A14.~~A21. GASB's Leases ~~exposure draft~~Statement No. 87 specifically excludes, "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently FASAB standards are silent on SCAs. Through its discussions the lease task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from ~~the lease standard~~this Statement. To accomplish ~~the exclusion~~this, the Board considered adopting GASB's definition of SCA from Statement No. 60 ~~due to the lack of~~because there is no a federal definition ~~of SCA.~~ The Board

eventually decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project and therefore the Board agreed to remain silent on SCAs in this Statement. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

~~Because SCAs are not currently addressed in federal accounting standards, the Board decided that specifically excluding SCAs from the lease standard would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project and therefore the Board agreed to remain silent on SCAs in the lease proposal. In conclusion, the Board believes the GAAP hierarchy will continue to guide preparers and auditors in accounting for SCAs.~~

DEFINITIONS

A22. In this Statement, A lease is defined as a contract or agreement that conveys the right to control the use of another entity's ~~property, plant, and equipment (PP&E)~~ (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. In the early stages of the project the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered the GASB approach that the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, the Board decided to add "agreement" in addition to "contract" in the lease definition to alleviate ambiguity in ~~the its~~ application. of the definition, especially This should be helpful in the case of intragovernmental leases which are often referred to as "lease agreements."

~~A15-A23.~~ The Board also reconsidered the broad scope of the lease definition which included all nonfinancial assets not specifically excluded in the standards. During deliberations after receiving comment letters, the Board determined that the broader lease definition would necessitate the development of a definition of "nonmonetary assets" and "intangibles." Also, several respondents and task force members advocated a more narrow definition of leases. In an effort to reduce preparer burden, the Board reconsidered its decision and reevaluated the benefits of a narrower lease definition. The Board decided to narrow the scope of the lease definition to only include PP&E.

LEASE TERM -- OPTIONS TO EXTEND OR TERMINATE

A24. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and fiscal funding mechanisms, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but it should include certain ~~probable~~ options to extend or terminate the lease and consider the

~~probability of options to terminate~~, so that the lease term reflects how long the lease is expected to be in effect.

~~A16-A25. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB's definition of probable, and FASB's probability threshold "reasonably certain." FASB's probable definition equates to more likely than not (>50% probability). GASB's probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB's reasonably certain probability has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.~~

~~A26. The probability of options to extend or terminate the lease applies only if that option pertains to the lessee alone. If either the lessee or the lessor has the option to terminate a lease (or if both parties have to agree to extend), the lease contract or agreement is not enforceable beyond that point. In those cases when either the lessee or the lessor could cancel the lease at any time, for example month-to-month lease holdovers, rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed, the contract or agreement would be considered cancelable. When a lease contains a lessor-only option to terminate the lease, a lessee would have difficulty evaluating the likelihood of that option being exercised. This difficulty and the resulting cost outweigh the potential benefits of including the extra periods in the lease term. The Board also agreed that the presence of a purchase option in a lease contract or agreement is not equivalent to a provision that transfers ownership of the underlying asset; therefore, a purchase option should be treated as any other option included in a lease. During deliberations after receiving comment letters, the Board considered additional ways to reduce the preparer's burden and agreed on the following points:~~

- ~~a. The "noncancelable period" language should be clarified.~~
- ~~b. Both the lessee and the lessor's options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.~~
- ~~c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold, however when the lessee or lessor is assessing the other party's options to extend or terminate the contract or agreement, the level of probability is at a higher threshold, like reasonably certain, and should be based on significant evidence.~~

~~A17-A27. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB's definition of probable, and FASB's probability threshold "reasonably certain." FASB's probable definition equates to more likely than not (>50% probability). GASB's probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB's reasonably certain has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable~~

~~because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.~~

REMEASUREMENT

~~A18-A28.~~ This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

SHORT-TERM LEASES

~~A19-A29.~~ The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the ~~lease~~-short-term lease exception with the PP&E standard which defines PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities ~~of~~ implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize those leases with useful lives or maturities of less than two years as expense and revenue based on the payment provisions of those lease contracts or agreements and those standards regarding recognition of accruals with useful lives or maturities of less than two years. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

~~A20-A30.~~ During the research phase of the project, the ~~General Services Administration (GSA)~~ provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

~~A24-A31.~~ This Statement provides the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or agreement that conveys the right to control the use an asset of another entity's PP&E (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47, ~~Reporting Entity~~. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease.

Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

~~A22.~~A32. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common, ~~and~~ therefore, the Board ~~decided to use~~ intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

~~A23.~~A33. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines a liability as a “present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.” The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.

~~A24.~~A34. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

~~A25.~~A35. ~~An A~~Assets are-is defined in SFFAC 5 as “a resources that embodies economic benefits or services that the federal government controls.” Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to control the ~~to use~~ of another entity's PP&E (the underlying asset), and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

RECOGNITION AND MEASUREMENT FOR LESSORS

~~A26-A36.~~ Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the ~~same-shared~~ transaction in a way that mirrors how the other party accounts for it.

~~A37.~~ The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to ~~control the~~ use ~~of~~ the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. ~~Assets are defined as a resource that embodies economic benefits or services that the federal government controls.~~ The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

BOARD APPROVAL

~~A27-A38.~~ This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

APPENDIX B: ABBREVIATIONS

ASC	Accounting Standards Codification
CFR	Consolidated financial report of the U.S. Government
ED	Exposure draft <u>Draft</u>
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
<u>GSA</u>	<u>General Services Administration</u>
IPSASB	International Public Sector Accounting Standards Board
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

APPENDIX C: GLOSSARY

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

Initial Direct **Lease** Costs

Initial direct **lease** costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases **and that** would not have been incurred without entering into the lease.

Intragovernmental Lease

An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*.¹⁴

Lease

A lease is a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

Lessee's **Estimated** Incremental Borrowing Rate

¹⁴ SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (see SFFAS 47 par. 38-42).

The lessee's estimated incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

Probable

Probable describes that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Short-Term Lease

A short-term lease is a lease with a lease term (as defined in paragraph 14) of 24 months or less.

FASAB ~~Board~~ Members

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R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

~~Christina Ho~~

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Federal Accounting Standards Advisory Board

LEASES:

AN AMENDMENT OF STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS
(SFFAS) 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT, AND
SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards XX

CLEAN VERSION

October 12, 2017

PRE-BALLOT DRAFT

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- [“Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board”](#)
- [“Mission Statement: Federal Accounting Standards Advisory Board,” exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters](#), and other items of interest are posted on FASAB’s website at www.fasab.gov.

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SUMMARY

This Statement revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definitions of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definitions of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. For purposes of applying this Statement, a **lease**¹ is defined as a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E)² (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.
3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, an entity should assess whether the federal entity has both of the following:
 - a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement
 - b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement
4. This definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 72). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.
5. This Statement does not apply to
 - a. leases of assets under construction or
 - b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

¹ Terms defined in the Glossary are shown in **bold-face** the first time they appear.

² SFFAS 6, *Accounting for Property, Plant, and Equipment*.

DEFINITIONS

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement that conveys the right to control the use of another entity's PP&E (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.
7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.
8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*.³
9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.
10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.
12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.
13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

³ SFFAS 47, *Reporting Entity*, par. 38–42.

LEASE TERM

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of
- a. the period identified in the lease contract or agreement that precedes any option to extend the lease or
 - b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.
15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:
- a. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option
 - c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option
 - d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option
16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.
17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:
- a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option
 - b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option

- or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option
- c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option
 - d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option
18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.
19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:
- a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend, are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.⁴
 - b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.
 - c. A fiscal funding or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.
20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraph 15-18, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

⁴ SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

- a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates
 - b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)
 - c. The history of exercising options to extend or terminate
 - d. The extent to which the asset underlying the lease is mission critical to the federal entity
21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:
- a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17
 - b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17
 - c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

SHORT-TERM LEASES

22. A short-term lease is a lease with a lease term (as defined in paragraphs 14 - 21) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

23. A lessee should recognize short-term lease payments as expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are

received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any rent holiday period (for example, one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14–19), but that may contain a fiscal funding or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.⁵

INTRAGOVERNMENTAL LEASES

26. An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting guidance described in paragraphs 27–38.
27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.
29. Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.
30. Variable rental increases are based on changes in specific economic factors, for example, future activity levels or future inflation (tied to a specific economic indicator where the specific amount of the change is not known).
31. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase as provided in the lease.

⁵ SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

32. Lease incentives should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term, and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.
33. Lease concessions should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.
34. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.
35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for PP&E.⁶
36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.
-

DISCLOSURES

37. Lessees should disclose a broad summary of significant intragovernmental leasing arrangements, including
- a. existence of intragovernmental leases and annual expense,
 - b. general lease terms with specific intragovernmental requirements (which may be grouped for purposes of disclosure), and
 - c. annual lease expense by major leased asset category.
38. Lessors should disclose the following regarding intragovernmental leases:
- a. Future lease payments that are to be received for each of the five succeeding fiscal years for lease arrangements over the lease term
 - b. A broad summary of significant leases (which may be grouped for purposes of disclosure), including a breakdown of the number of leases with federally-owned assets and privately-owned assets

⁶ This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, *Accounting for Property, Plant and Equipment*, par. 37.

LESSEE RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES,

39. At the commencement of the lease term, a lessee should recognize a lease liability and a PP&E right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraph 26–38 (intragovernmental leases).

LEASE LIABILITY

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable payments that are fixed in-substance as described in paragraph 41
 - d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees
 - e. The exercise price of a purchase option if it is probable that the lessee will exercise that option
 - f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) a fiscal funding or cancellation clause
 - g. Any lease incentives (par. 69–70) receivable from the lessor
 - h. Any other payments that are probable of being required based on an assessment of all relevant factors
41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.
42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be

reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**⁷ (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.
44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes⁸ have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:
- a. There is a change in the lease term.
 - b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable, or vice versa.
 - c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.
 - d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).
 - e. There is a change in the interest rate the lessor charges the lessee, if used as the initial **discount rate**.
 - f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.
45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

⁷ A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

⁸ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 79–85 for lease modifications and terminations.

46. The lessee also should update the discount rate as part of the remeasurement if one or both of the changes in paragraph 44.a or 44.c have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability.
47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.
48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

49. A lessee should initially measure the lease asset as the sum of the following:
- a. The amount of the initial measurement of the lease liability (par. 40)
 - b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 69–70)
 - c. Initial direct lease costs that are necessary to place the lease asset into service
50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.
51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.
52. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraph 44–48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.
53. Leased assets classified as PP&E are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The change in the manner or duration of use of the underlying asset is an indicator that the right of use asset may be impaired (SFFAS 44, par. 12). If the underlying asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.⁹

DISCLOSURE REQUIREMENTS FOR LESSEES

⁹ SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18–25.

54. A lessee should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including:
 - i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined
 - ii. the existence, terms, and conditions of residual value guarantees provided by the lessee
 - b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets
 - c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability
 - d. Principal and interest requirements to maturity, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter
 - e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

LESSOR RECOGNITION AND MEASUREMENT FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:
- a. Fixed payments
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term
 - c. Variable lease payments that are fixed in-substance as described in paragraph 57
 - d. Residual value guarantees that are fixed payments in substance (par. 57)

- e. Any lease incentives (par. 69–70) payable to the lessee
57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.
58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.
59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.
60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.
61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes,¹⁰ and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:
- a. There is a change in the lease term.
 - b. There is a change in the interest rate the lessor charges the lessee.
 - c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

¹⁰ Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 79–85 for lease modifications and terminations.

62. If a lease receivable is remeasured for either of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.
63. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes in paragraph 61.a or 61.b have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable.

DEFERRED REVENUE

64. A lessor initially should measure the deferred revenue to include the following:
- a. The amount of the initial measurement of the lease receivable (par. 56)
 - b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 69–70) paid to, or on behalf of, the lessee at or before the commencement of the lease term
65. A lessor subsequently should recognize the deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63.

UNDERLYING ASSET

66. A lessor should not derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

DISCLOSURES FOR LESSORS

67. A lessor should disclose the following about its lease activities (which may be grouped for purposes of disclosure), other than short-term leases:
- a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined
 - b. The carrying amount of assets on lease, by major classes of assets, and the amount of accumulated depreciation

- c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases
 - d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties
68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

LEASE INCENTIVES AND LEASE CONCESSIONS

69. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.
70. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 401–48) and by lessors consistently with the lessor's lease receivable (par. 56–63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. However leasehold improvements are paid for (financed) by the lessee, therefore leasehold improvements would not be considered a lease incentive or concession received from the lessor.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

71. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

72. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 75.
73. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 75.
74. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.
75. If a contract or agreement does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph 74, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.
76. If multiple components are accounted for as a single lease unit as provided for in paragraph 75, the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

77. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:
- a. The contracts or agreements are negotiated as a package with a single objective.
 - b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.

78. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 71–76.

LEASE TERMINATIONS AND MODIFICATIONS

79. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast, exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

80. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

Lessee Treatment of Lease Terminations

81. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

Lessor Treatment of Lease Terminations

82. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

83. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:
- a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.

- b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

Lessee Treatment of Lease Modifications

84. Unless a modification is reported as a separate lease as provided in paragraph 83, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the flows statement as a gain.

Lessor Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in paragraph 83, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

86. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.
87. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

88. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale¹¹ to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

¹¹ See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

89. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the flow statement in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.
90. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.
91. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 54). A buyer-lessor should provide the disclosures required of a lessor (par. 67).

LEASE-LEASEBACK TRANSACTIONS

92. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

AMENDMENTS TO SFFAS 5, *ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT*, AND SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

93. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 43–46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

~~[43.] **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~

- ~~The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

~~[44.] The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote 20: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment."] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

~~[45.] The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

~~[46.] During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit Cost Analysis of Federal Programs," provides the requirements under which a lease purchase or other capital lease has to be justified and the analytical methods that need to be followed.]~~

94. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: Accounting for Property, Plant, and Equipment

~~[20.] Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote 21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease purchases with more~~

~~or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [footnote 22: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]~~

- ~~• The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~• The lease contains an option to purchase the leased property at a bargain price.~~
- ~~• The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.~~
- ~~• The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.~~

~~[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).~~

IMPLEMENTATION

95. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,
 - a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and
 - b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.
96. The following implementation addresses specific leasing circumstances.
 - a. Prospective Implementation – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles*,

Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources.

Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.

- b. Lease Term – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.
- c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22–24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

97. The requirements of this Statement are effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

- A1. This Statement amends the lease accounting standards in SFFAS 5 and 6, which had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.
- A2. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) undertook this project primarily because SFFAS 5 and 6
- a. do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions and
 - b. are based on Financial Accounting Standards Board (FASB) lease accounting standards, which have been amended.
- A3. Lease accounting was first addressed by FASAB during the development of SFFAS 5 and 6. At that time, the Board decided to use the high-level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) – Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.
- A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically covered in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to lessen confusion on whether FASB standards apply to federal entities when FASAB’s are silent on a topic.
- A5. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.
- A6. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. Staff sought the task force’s views

and recommendations in developing and describing alternatives to present to the Board. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the exposure draft (ED) preceding this Statement.

A7. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:

- a. FASB's SFAS 13, *Accounting for Leases* [superseded by FASB's ASC 840, which was subsequently superseded by ASC 842]
- b. Governmental Accounting Standards Board's (GASB) Statement No. 87, *Leases*
- c. International Accounting Standards Board's International Accounting Standard 17, *Leases* [superseded by International Financial Reporting Standard 16]
- d. International Public Sector Accounting Standards Board's International Public Sector Accounting Standard 13, *Leases*

A8. At the inception of the project, the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of this Statement. In 2014, FASAB and GASB met to discuss issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.¹²

A9. This Statement amends the lease accounting standards in SFFAS 5, SFFAS 6, and TR 16. This Statement also establishes distinct standards for intragovernmental leases.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A10. FASAB issued the ED, titled *Leases*, on September 26, 2016, with comments requested by January 6, 2017. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A11. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

- a. House Committee on Oversight and Government Reform

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- b. House Committee on Transportation
- c. House Committee on Budget
- d. Senate Committee on Homeland Security and Governmental Affairs
- e. Senate Committee on Budget
- f. Senate Committee on Environment and Public Works

A12. FASAB received 25 responses from preparers, auditors, professional associations, and citizens. Many respondents had concerns with the definition of leases and the scope of the Statement. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A13. The Board extended an invitation to the respondents of the Leases ED to discuss with the Board their comments on the ED and provide further clarification on their responses. In April 2017, five federal entities addressed the Board to further elaborate on their written comments.

A14. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

KEY AREAS OF IMPROVEMENT

A15. This Statement will improve upon the existing guidance in SFFAS 5 and 6 by providing

- a. relevant and meaningful financial information needed by federal financial statement users and
- b. comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

A16. As previously noted, the lease accounting standards in SFFAS 5 and 6 were based on the FASB lease accounting standards, which have been amended. Because FASB revised its standards, it was imperative for the Board to revisit the lease accounting standards, and inaction was not an option. The Board closely reviewed the lease proposals of three standards setters to determine what underlying concepts, if any, would be useful for federal lease accounting and financial reporting. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.

A17. The Board strongly considered the costs associated with the lease proposal. Those cost considerations are especially evident with the proposed accounting for short-term and intragovernmental leases. Aside from the General Services Administration's (GSA) lease portfolio, the majority of federal entity lease contracts and agreements are intragovernmental leases. This Statement will lessen the preparer's level of effort to account

for intragovernmental leases in comparison to the current lease accounting and financial reporting standards.

A18. The Board believes that in a lease transaction, a lessee receives the right to control the use of another entity's PP&E (the underlying asset—the asset that is subject to the lease, such as a vehicle or building) for a period of time as specified in the contract or agreement. In exchange, the lessee promises to make payments over time for the right to control the use of that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because they often resulted in similar leases being accounted for in different ways.

SCOPE

A19. For purposes of applying this Statement, a lease is defined as a contract or agreement that conveys the right to control the use of another entity's PP&E (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. Service contracts include maintenance of equipment or real property, advisory services, communications services, transportation services, and research and development.

A20. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

A21. GASB's Leases Statement No. 87 specifically excludes "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently, FASAB standards are silent on SCAs. Through its discussions, the task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from this Statement. To accomplish this, the Board considered adopting GASB's definition of SCA from Statement No. 60 because there is no federal definition.

A22. The Board eventually decided that specifically excluding SCAs from the standards would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project; therefore, the Board agreed to remain silent on SCAs in this Statement. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

DEFINITIONS

A23. In this Statement, a lease is defined as “a contract or agreement that conveys the right to control the use of another entity’s PP&E (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.” In the early stages of the project, the Board deliberated over the use of “contract” or “agreement” in the definition of a lease. The Board considered GASB’s approach—that the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, the Board decided to add “agreement” in addition to “contract” in the lease definition to alleviate ambiguity in its application. This should be helpful in the case of intragovernmental leases, which are often referred to as “lease agreements.”

A24. The Board also reconsidered the broad scope of the lease definition, which included all nonfinancial assets not specifically excluded in the standards. During deliberations after receiving comment letters, the Board determined that the broader lease definition would necessitate the development of a definition of “nonmonetary assets” and “intangibles.” Also, several respondents and task force members advocated a more narrow definition of leases. In an effort to reduce preparer burden, the Board reconsidered its decision and reevaluated the benefits of a narrower lease definition. The Board decided to narrow the scope of the definition to only include PP&E.

LEASE TERM – OPTIONS TO EXTEND OR TERMINATE

A25. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and fiscal funding mechanisms, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but it should include certain options to extend or terminate so that the lease term reflects how long the lease is expected to be in effect.

A26. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB’s definition of probable, and FASB’s probability threshold “reasonably certain.” FASB’s probable definition equates to more likely than not (>50% probability). GASB’s probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB’s reasonably certain probability has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly defined and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

A27. During deliberations after receiving comment letters, the Board considered additional ways to reduce the preparer’s burden and agreed on the following points:

- a. The “noncancelable period” language should be clarified.

- b. Both the lessee and the lessor's options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.
- c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold; however, when the lessee or lessor is assessing the other party's options to extend or terminate the contract or agreement, the level of probability is at a higher threshold, like reasonably certain, and should be based on significant evidence.

REMEASUREMENT

A28. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

SHORT-TERM LEASES

A29. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the short-term lease exception with the PP&E standards, which define PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize those leases with useful lives or maturities of less than two years as expense and revenue based on the payment provisions of those lease contracts or agreements and those standards regarding recognition of accruals. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

A30. During the research phase of the project, GSA provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A31. This Statement provides the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or

agreement that conveys the right to control the use of another entity's PP&E (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

A32. The terms "intragovernmental" and "inter-entity" have been used interchangeably. Earlier FASAB standards predominately used "inter-entity." However, government-wide usage of "intragovernmental" has become more common; therefore, the Board used intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

A33. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines a liability as a "present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.

A34. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE ASSET

A35. An asset is defined in SFFAC 5 as "a resource that embodies economic benefits or services that the federal government controls." Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to control the use of another entity's PP&E (the underlying asset), and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

RECOGNITION AND MEASUREMENT FOR LESSORS

A36. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the shared transaction in a way that mirrors how the other party accounts for it.

A37. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to control the use of the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

BOARD APPROVAL

A38. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

APPENDIX B: ABBREVIATIONS

ASC	Accounting Standards Codification
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
GSA	General Services Administration
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

Initial Direct Lease Costs

Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Intragovernmental Lease

An intragovernmental lease is a contract or agreement that conveys the right to control the use of another entity's PP&E asset (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*.¹³

Lease

A lease is a contract or agreement that conveys the right to control the use of another entity's property, plant, and equipment (PP&E) (the underlying asset) for a period of time as specified in the contract or agreement in exchange for consideration.

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

¹³ SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (SFFAS 47 par. 38–42).

Lessee's Estimated Incremental Borrowing Rate

The lessee's estimated incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

Probable

Probable describes that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Short-Term Lease

A short-term lease is a lease with a lease term (as defined in par. 14) of 24 months or less.

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History of Board Lease Discussions

- ❖ The objective for the August 2017 meeting was for the Board to review the draft Leases Statement and give staff feedback on any technical issues so that a pre-ballot draft can be provided to the Board by the October meeting.

Staff made the necessary edits to the *Leases Exposure Draft (ED)* to convert the document from an ED to a draft Statement based on

- Board discussions related to responses to the 2016 *Leases Exposure Draft (ED)*
- Board discussions with representatives from five federal entities at the April 2017 meeting on their views on the ED
- Staff editorial changes for understandability and readability of the standard, including revisions adapted from GASB's final Leases standard.

At the August meeting staff discussed the following three issues with the Board:

- Definition of a lease
- Service contracts
- Lease term determination
- Effective date of standard
- Other revisions to the standard
- Possibility of re-exposure

The Board agreed to revise the standard to include the narrower lease definition to, *“a contract or agreement that conveys the right to control the use of another entity's identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration”*.

The Board agreed to include the definition of service contracts in the Leases standard.

The Board agreed to add language that would clarify the “noncancelable period” and agreed that both the lessee and the lessor's options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement. The Board agreed that when the lessee or lessor was assessing its own options to extend or terminate the contract or agreement the level of probability is at the probable threshold, whereas when the lessee or lessor was assessing the other party's options to extend or terminate the contract or agreement the level of probability is at a higher threshold, like reasonably certain which requires significant evidence.

The Board agreed to change the effective date of the Leases standard to reporting periods beginning after September 30, 2020 (FY 2021). The Board agreed to several editorial changes. The Board unanimously agreed that re-

exposure of the Leases standard was not necessary based on the substance of the revisions.

Next Steps: Staff will make the necessary revisions to the draft standard based on all Board discussions since the exposure draft and present a pre-ballot draft to the Board by the October meeting.

- ❖ The objective for the June 2017 meeting was for the Board to provide direction to staff on the issues raised in the briefing materials and to raise any other technical issues for staff to address. Staff would like to have any remaining technical issues addressed at the August meeting so that a pre-ballot draft can be provided to the Board after the August meeting.

At the February 2017 FASAB meeting the Board considered responses to its 2016 Leases Exposure Draft (ED) and at the April 2017 meeting representatives from five federal entities discussed their comments on the ED with the Board. The Board asked staff to consider additional scope exclusions, continue to highlight the benefits associated with revising the leases standard, and explore options to ease the anticipated burdens and costs of the lease revisions to federal preparers.

At the June meeting staff discussed the following three issues with the Board:

- Definition of a lease
- Scope of the revised lease standards
- Lease term determination

The Board agreed with the broader definition of a lease over the more narrow definition of a lease that would only include property, plant, and equipment (PP&E). The broader definition will allow flexibility for leases that are not PP&E or those not specifically scoped out to be considered for recognition in accordance with the standards.

The Board agreed with the additional scope exclusions. The scope exclusions will include, natural resources per SFFAS 38 and TB 2011-1, leases of inventory, leases of assets under construction, leases of intangibles, and leases (licenses) of internal use software. With the broader definition an entity would need to identify all items meeting the definition and justify the exclusions. The broader definition encourages entities to evaluate the substance of the transaction.

The Board agreed to revise the lease term determination language but retain the probable threshold. Staff will also work to ensure the lease term determination language is clear and includes the necessary explanations and definitions. The probable threshold gives the entity a better basis for assessing the lease term as opposed to the higher reasonably certain threshold which could be more challenging to establish.

Next Steps: Staff will make the necessary revisions to the draft standard based on all Board discussions since the exposure draft and present the draft to the Board at the August meeting.

- ❖ At the April 2017 meeting, five federal entities addressed the Board; each entity was given 40 minutes for opening remarks and questions from Board members.

AGENCY	PRESENTERS' NAMES
Department of Agriculture	Michael Moore
Department of Energy	William Truitt, John Wall, and Tynesha Douglass
Department of the Interior	Terri Windlan and Sherry Lee
Department of Defense	Alaleh Jenkins, Edwin Oshiba, Jim Omans, Michael Walsh, and Steven Hurwitz
General Services Administration	Robert (Bob) Smalskas and Edward Gramp

Mr. Showalter began the clarification discussion by informing the Board that the objective of the session was to listen to the presenters, ask questions of the presenters, and give staff direction on the next steps of the project.

During the discussion several points were made by the presenters, including some of the following:

- The lease proposal will require additional cost to entities by way of added personnel and system upgrades, both during the implementation period and ongoing periods. Most of the presenters were not prepared to give specific estimates of those additional costs.
- Implementation guidance with specific examples will be helpful in the application of the revised lease standards, including related U.S. Standard General Ledger (USSGL) accounts.
- Departments will need to assess the remeasurement of the lease liability quarterly.
- The proposed lease definition should be clearer and more narrowly scoped.
- Clarification is needed for contracts for services when an asset is involved; for example, how a department should unbundle the contracts.

The Board asked staff to address some of the issues raised by the presenters.

- Staff should develop a list of possible items to be scoped out, including intangibles.
- Staff should get a clearer understanding of the benefits associated with revising the leases standards.
- Staff should explore options to ease the anticipated burden and cost of the lease revisions to federal preparers.

Next Steps: Staff will reach out to the presenters as well as other members of the lease task force to address the issues identified by the Board and return with recommendations.

- ❖ At the February Board meeting, staff provided to the Board the 25 comment letters received on the *Leases* ED, several tables that summarized the comment letters, an initial staff analysis of issues identified by respondents, and questions for Board discussion.

Members agreed to extend an invitation to all respondents of the ED to address the Board and provide further clarification on their responses to the *Leases* ED at the April meeting.

The Board agreed with staff that implementation guidance would be necessary to assist entities to effectively implement the amendments to the *Leases* standards.

The Board discussed issues raised in the responses to the *Leases* ED. There were no Board decisions based on staff's recommendations because members wanted additional feedback from the respondents on the following issues:

- The addition of the notion of control to the lease definition as well as language connecting the definition to that of an asset in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*
- The change of the term "nonfinancial asset" to "nonmonetary asset" in the final amended *Leases* Statement
- The method used in determining the lease term, including what is considered the "noncancelable period" proposed in the ED
- The probability threshold used when assessing whether renewal and termination options will be exercised
- The initial lessee recognition proposed in the ED
- The recognition and measurement of the lease liability by the lessee proposed in the ED
- The interest rate used to calculate the lease liability proposed in the ED
- The circumstances when the lessee must remeasure the lease liability proposed in the ED

- The recognition and measurement of the lease asset by the lessee proposed in the ED
- The lease term of 24 months or less for a short-term lease proposed in the ED
- The change of the definition of short-term lease from “a lease that, at the beginning of the lease, has a maximum possible term under the contract/agreement of 24 months or less, including any options to extend, regardless of its probability of being exercised” to “a lease with a lease term (as defined in paragraph 14) of 24 months or less”
- The change of the effective date of the amended leases standards to fiscal year 2020

Next Steps: Staff will extend an invitation to all 25 respondents of the *Leases* ED to allow them to speak before the Board to provide clarification on their responses to the ED and for the members to ask questions of the respondents. The clarifying discussion will take place on April 26, the first day of the next FASAB meeting. Staff will also prepare a package for the Board with materials to facilitate the discussion. Additionally, staff will continue with an analysis of the comments for Board consideration.

- ❖ The Board released for public comment on September 26, 2016 the proposed SFFAS entitled *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment*, which was. The Board requested comments on the exposure draft by January 6, 2017.
- ❖ At the August Board meeting, staff provided to the Board a pre-ballot draft ED on lease accounting. The objective of the session was for the Board to provide feedback to staff and approve the Lease ED pre-ballot draft.

The following topics were presented by staff and discussed by the Board.

- Comment Period End Date – The Board agreed to the comment period end date of January 6, 2017.
- Proposed Effective Date – Staff proposed an effective date of periods beginning after September 30, 2019. Members agreed to propose an effective date of September 30, 2018, and revise the date to September 30, 2019, if the Board gets a negative reaction to the 2018 effective date. The Board also agreed to not allow early adoption of the standard to maintain consistency among the reporting entities.
- Public Hearing – Staff proposed scheduling a public hearing for April 26, 2017, and providing notice of the public hearing in the ED. The Board agreed that scheduling a public hearing should be determined based on the responses to the

comment letters. Therefore, the ED will not include the scheduling of a public hearing; however, the possibility of a public hearing will be noted in the ED.

- Remeasurement Respondent Questions –The Board agreed to add a question to the ED to address the effect of remeasurement on the lease liability and asset, as well as language in the basis for conclusions to reflect the Board's rationale. They also agreed to add a question to address whether certain remeasurement triggers would cause significant costs to the preparer.
- Implementation Guidance – The Board agreed to propose the prospective implementation approach, which requires that leases unexpired at the beginning of the reporting period be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation. This approach includes examples of implementation scenarios.

Next steps: The next steps are to incorporate all of the Board's edits, send the Board a ballot draft of the ED for approval, and release the ED by the end of September.

- ❖ At the June Board meeting, staff provided to the Board a draft ED on lease accounting and task force responses to several lease-related questions posed by staff. The objective of the session was to review responses to seven questions staff had posed to the lease task force related to issues in which the Board had requested additional information and review a draft Lease ED.

The Board made the following tentative decisions.

- The Board agreed with the staff recommendation to propose the use of FASAB's definition of probable (more likely than not – >50%) as the probability threshold in the Lease ED. The Board also directed staff to include probability threshold as a question in the ED.
- The Board agreed to propose that the leased asset be classified as property, plant, and equipment (PP&E) unless the underlying asset is not PP&E; in those cases the leased asset would be classified to align with the nature of the underlying asset.
- The Board agreed that the basis for conclusions should tell the story of how the Board arrived at its conclusions and the Board's collaboration with the Governmental Accounting Standards Board (GASB). The basis for conclusions should not specifically note when FASAB's proposed guidance diverges from GASB's guidance unless the Board deliberated on GASB's approach. In those instances when the Board considered GASB's approach, staff will include the highlights of the discussion and how the Board came to its conclusions.
- The Board agreed to add some verbiage to the basis for conclusions on rent increases, lease incentives, and lease concessions.

Next steps: Staff will make the revisions discussed at the meeting to the draft ED and provide a pre-ballot draft for the August meeting.

- ❖ At the April Board meeting staff members presented to the Board one issue related to developing the exposure draft (ED) of the proposed standards on non-intragovernmental lease accounting. The Board previously directed staff to use the Governmental Accounting Standards Board's (GASB) proposal on Leases as a platform for developing the federal standards on non-intragovernmental lease – the GASB ED was released for comment in January 2016.

The objective of the session was to address the issue of service concession arrangements (SCAs) in the proposed lease standards. Staff noted GASB's Leases ED specifically excludes, "Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements." Currently FASAB standards are silent on SCAs.

The Board agreed that because SCAs is a topic not previously addressed in federal accounting standards, specifically excluding SCAs from the lease standard would raise more questions about SCAs. Therefore, members concluded that SCAs should not be addressed in the lease standard. Although SCAs are expected to be addressed in the P3 recognition and measurement project, the Board agreed to remain silent about SCAs in the lease proposal but to include the Board's rationale in its BFC. The Board may also consider asking a question about SCAs of the respondents to the ED.

- ❖ At the February 2016 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff made several revisions to the language contained in the GASB proposal to reflect differences at the federal level, any conflicts with existing FASAB standards, and any changes to which the Board had previously agreed. In addition, staff also posed 23 questions to the Board related to the draft. The questions highlight areas where the FASAB proposal deviates from the GASB proposal, areas where the task force has raised questions, and areas where overall general questions on the proposal were appropriate.

Mr. Showalter asked staff to highlight only the areas in which Board members had additional questions, as well as the areas in which staff would like further direction from the Board, due to the number of questions put forth by the staff.

Capitalization Thresholds: Staff stated that because SFFAS 6, Accounting for Property, Plant, and Equipment (PP&E) specifically addresses capitalization thresholds, a task force member questioned whether the lease standards would allow federal entities to establish capitalization thresholds for lease assets. Staff also noted that GASB does not address the issue of capitalization thresholds in the standards sections of the lease ED, but in the basis for conclusions.

The Board agreed to not specifically address capitalization thresholds in the lease proposal but to discuss overall materiality in the application of the standard, which would then apply to the materiality of the related lease liability and lease asset.

Lessee Incremental Borrowing Rate: Staff noted that GASB proposes use of the incremental borrowing rate if the actual or implicit rate charged by the lessor cannot be readily determined. This is consistent with current FASAB standards. However, the incremental rate for federal borrowers is the Treasury rate—a risk-free rate.

Staff noted that the risk-free rate is not reflective of the lessor's implicit rate, and the risk-free rate would understate the interest expense. Staff also suggested that the language in paragraph 20 be modified from "If the rate cannot be readily determined..." to "If the rate cannot be reasonably estimated by the lessee, the lessee's incremental borrowing rate (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used."

The Board agreed with the revised language.

Lease Liability Remeasurement—Due to a Change in an Index or Rate: Staff noted that GASB proposes that the lease asset be adjusted when the corresponding lease liability is remeasured. GASB also proposes that the effects of a lease liability remeasurement, due to a change in an index or rate used to determine variable payments, be recognized the same way as the effects of remeasurement for other reasons. This would be an adjustment to the lease asset, rather than recognition in the flows statement (as proposed in the Preliminary Views). GASB proposed the change primarily due to cost-benefit concerns.

The Board agreed to remain consistent with GASB's approach that the lease asset be adjusted when the corresponding lease liability is remeasured in all instances.

Insignificant Lease Components: Staff noted that the Board had previously agreed that the guidance should exempt leases with multiple insignificant and unpriced components from applying methods to disaggregate the components.

The draft language would read, "If a contract/agreement does not include prices for individual components, or if those prices are not reasonable based on other observable stand-alone prices, lessors and lessees should do the following, unless the components as a whole are not considered significant."

The Board had no objections to the edit.

- ❖ At the December 2015 meeting staff updated the Board on the lease project, including the status of the GASB lease project. The Board had previously directed staff to use the GASB lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff noted that the GASB is in the final stages of finalizing their exposure draft (ED) and expects to release the ED for comment in early February 2016. FASB plans to release their final lease standard in early 2016 with an effective date of 2019.

Staff's goal is to have the FASAB lease ED available for comment by mid-2016. Staff also held a lease task force meeting in early-February 2016.

There was also a brief discussion on the accounting for lease holdovers, in light of a recent GAO report.

Lastly, there are plans to convene another FASAB/GASB joint meeting in 2016.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the October 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with excerpts from the tentative GASB Board meeting minutes from their September 1, 2015 lease discussion. The following GASB lease topics were presented to the Board.

- Airport Leases and Related Issues
- Lessee Disclosures
- Lessor Disclosures
- Short-Term Lease Exception
- Lease Terminations and Modifications
- Subleases and Leaseback Transactions

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the August 2015 meeting staff updated the Board on GASB's deliberations of their lease project. The Board had previously directed staff to use the GASB Lease proposal as a platform for developing the FASAB standards on non-intragovernmental leases.

Staff provided the Board with eleven discussion items that staff compiled from the last three GASB lease discussions (April, June, and July 2015). The eleven issues represented those lease topics that GASB either changed its position from the November 2014 Lease Preliminary Views document or topics that FASAB will need to further discuss as the exposure draft is developed. The following discussion items were presented to the Board.

- Defining “nonfinancial asset”
- Intangible (lease) assets
- The role of “control” in determining whether a transaction qualifies as an asset
- Service concession agreements
- Bargain purchase options
- Month-to-month holdover periods
- Probability threshold
- Lessee renewal/termination options
- Fiscal funding clauses
- Lease liability remeasurement
- Allocation of consideration to multiple components

A Board member suggested just giving examples or asset classes of nonfinancial assets, if a clearer definition cannot be developed. The Board asked staff if federal leases would go beyond the scope of capital assets (real and personal property). The Board asked staff to comeback with options to defining nonfinancial assets.

Staff noted that the FASAB “probable” definition equates to “more likely than not” and “reasonably certain” has an even higher threshold than GASB’s “probable (likely to occur).” Since FASAB previously noted that it was comfortable with the differences between our “probable” and GASB’s “probable,” staff recommends not accepting GASB’s change to “reasonably certain” and staying with the FASAB “probable” definition, because there seems to be no compelling reason to introduce a new term for the sake of a higher threshold. The Board did not disagree with staff’s recommendation.

The Executive Director reminded the Board that all of the issues will be brought back to the Board for more discussion before the exposure draft is finalized.

Staff will continue to work with the task force to further develop the lease standards and will continue to follow the progress of the GASB lease discussions.

- ❖ At the April meeting staff presented to the Board an initial draft exposure draft (ED) for the intragovernmental portion of the leases standard. Staff noted that the lease standard will include guidance for all federal leases, including intragovernmental leases. The Board has tentatively agreed that intragovernmental leases should be accounted for similar to current operating leases guidance. The draft ED included definitions of relevant terms, as well as specific provisions that address the recognition and measurement of intragovernmental leases for both the lessee and the lessor. Staff asked the Board if they agreed with the proposed language. The Board generally agreed with the staff proposal and asked staff to provide clarifying language in several sections of the proposal.

Staff also presented to the Board a summary of possible FASAB-relevant comments from the Governmental Accounting Standards Board’s (GASB) Preliminary Views (PV) on Leases. The Board had previously directed staff to use the GASB Lease PV as a platform for developing the FASAB standards on non-intragovernmental leases.

GASB received 37 comment letters on their lease PV and held three public hearings and expects to issue its exposure draft in February 2016 and a final standard in early 2017. Since the Board previously agreed to use the GASB lease accounting proposal as the foundation for the FASAB lease account proposal and any wording differences could denote a difference in meaning, staff recommended that the FASAB ED also be released close to that same timeframe as the GASB ED. The Board agreed to stay in sync with the GASB timeline for the release of the lease ED and final standard.

- ❖ At the February meeting staff presented to the Board a discussion paper that provided an analysis of the final six chapters of the Governmental Accounting Standards Board (GASB) Preliminary Views (PV) on Leases. The GASB PV on Leases is being used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements – the GASB PV was released for comment in November 2015. The topics discussed included lessee accounting, lessor accounting, short-term exception, lease terminations and modifications, subleases and leaseback transactions, and leases with related parties, and intra-entity leases.
- ❖ At the December 2014 meeting staff presented to the Board proposed guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that address features of leases and is based on the current Financial Accounting Standards Board operating lease guidance. The Board had previously directed staff to simplify the intragovernmental lease accounting guidance. Staff presented revisions to the previously proposed recognition and disclosure lessee and lessor guidance for intragovernmental lease arrangements. The Board stressed consistency and the need for symmetry between the lessee and lessor accounting for intragovernmental leases

Staff also presented an analysis of the first three chapters of the GASB Preliminary Views (PV) on Leases so that the Board could discuss the GASB concepts as it relates to the development of federal lease standards. The GASB PV on Leases will be used as a foundation for the development of the FASAB lease standards on non-intragovernmental lease agreements– the GASB PV was released for comment in November. The topics discussed were project objective, project background, applicability, scope, and lease term.

- ❖ At the October 2014 meeting staff presented to the Board proposed draft guidance for intragovernmental leases. The proposed guidance included definitions of relevant terms, as well as specific provisions that addressed features of leases and that is based on the current FASB operating lease guidance.

Staff proposed seven lease-related definitions to the Board for discussion. The first three definitions – lease, intragovernmental and intragovernmental lease agreement – were discussed and tentatively agreed to by the Board at previous meetings. The remaining four proposed lease-related definitions – intragovernmental lease inception, intragovernmental minimum lease payments, intragovernmental noncancelable lease term, and intragovernmental sublease – were adapted from

FASB's existing operating lease guidance. The Board asked staff to simplify the proposed definitions and discuss with the task force.

Staff also presented proposed recognition and disclosure lessee guidance for intragovernmental lease arrangements. The Board agreed that the lessee general guidance would be to recognize lease payments as they are received and specific provisions would address those instances when the "due and payable" is not applicable.

The Board also agreed that certain scheduled rent increases, rent holidays, and lease incentives should be recognized on a straight-line basis – possibly using the proposed language used for the amortization of leasehold improvements.

- ❖ At the August 2014 meeting the Board discussed and agreed to a definition for the term "intragovernmental" to refer to occurring within a consolidation entity or within or between two or more consolidation entities.

The Board discussed and agreed to proposed definitions of leases and of intragovernmental lease arrangements.

The Board discussed staff's proposal for recognizing operating leases--straight-line for lease costs and in the current period for executory costs. The Board members agreed with the straight-line concept for lease payments, but would like additional information before deciding whether executory costs should be required to be separated from the rental payment.

The next decision related to the proposed disclosure of future lease payments. Some questioned whether this disclosure was necessary for intragovernmental lease arrangements. The Board agreed to exclude the disclosure, but to ask a question in the exposure document whether the disclosure is necessary.

The Board agreed that the lessor revenue recognition would match the lessee's expense recognition—on the straight-line basis.

The Board agreed that upfront lease costs for lessors would be expensed

Regarding potential disclosures of future lease payments of lessors, there were no objections to the proposed disclosures.

- ❖ At the June 2014 Board meeting a majority of the Board agreed with a simplified approach for recognizing amounts arising from intragovernmental lease arrangements. The Board agreed that intragovernmental lease arrangements should be accounted for differently than leases between federal entities and non-federal entities.

The Board suggested referring to the project as "leases, including similar intragovernmental lease arrangements" (similar intragovernmental lease arrangements are in substance leases) to differentiate the intragovernmental arrangements from the non-federal arrangements. This would allow the two types of transactions to be disclosed separately.

The Board also agreed not to pursue issuing a preliminary views (PV) document on leases and to tentatively plan to issue its exposure draft (ED) on leases and other similar arrangements close to when the Governmental Accounting Standards Board (GASB) will issue its ED. Because GASB plans to issue a PV prior to its ED, staff will have an opportunity to seek informally feedback from the federal community on the GASB PV.

- ❖ At the April 2014 meeting the U.S. General Services Administration (GSA) provided an educational session with the goal of the Board gaining a better understanding of several GSA lease-related topics.
- ❖ At the March 2014 the Board met jointly with the GASB to discuss similar issues related to each of their ongoing lease accounting projects. Both Boards agreed that they should begin with the goal of developing symmetry between the lessee and lessor models. The FASAB was also very focused on the intragovernmental leasing issues involving federal entities and those federal-specific lease issues.
- ❖ In January 2014 staff asked the Board to provide their input in a survey format on the tentative decisions made by the GASB on their lease project to date. Based on the results of the survey, staff identified several topics for further discussion during the joint meeting with GASB.
- ❖ At the December 2013 meeting the Board briefly discussed the GASB tentative decisions on their leases project to date with the GASB Practice Fellow leading their leases project.
 - ✓ The Board tentatively agreed that based on Statement of Federal Financial Accounting Concepts (SFFAC) 5's definition of an asset and liability a federal entity's **right to use** a leased asset and the **obligation to make lease payments** are assets and liabilities of the entity.
 - ✓ All of the members agreed to explore the single-model approach as opposed to the dual-model approach.

Other Lease Discussions

- ❑ FASAB staff members met with OMB staff on April 30, 2014 to discuss budget scoring for capital leases. OMB staff explained that Appendix B of OMB Circular A-11, which provides instructions on the budgetary treatment of lease-purchases and leases of capital assets, is consistent with the scorekeeping rule developed by the executive (OMB) and legislative branches (CBO) originally in connection with the Budget Enforcement Act of 1990 (BEA). Statement of Financial Accounting Standards 13, issued by FASB, was the "support" for the scorekeeping rules developed. Because the lease budget scoring rules were developed in connection with the BEA and cannot be changed unless all of the scorekeepers (OMB, CBO, and the Budget Committees) agree, it is not likely that the rules will change based on

potential changes in the financial accounting for leases. OMB staff provided other helpful insights which we will explore further later in the project.